



# Instructions for Form 8582

## Passive Activity Loss Limitations

(Section references are to the Internal Revenue Code unless otherwise noted.)

### Paperwork Reduction Act Notice

We ask for this information to carry out the Internal Revenue laws of the United States. We need it to ensure that taxpayers are complying with these laws and to allow us to figure and collect the right amount of tax. You are required to give us this information.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

<b>Recordkeeping</b> . . . . .	40 min.
<b>Learning about the law or the form</b> . . . . .	1 hr., 11 mins.
<b>Preparing the form</b> . . . . .	1 hr., 24 mins.
<b>Copying, assembling, and sending the form to IRS</b> . . . . .	20 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form more simple, we would be happy to hear from you. You can write to either **IRS** or the **Office of Management and Budget** at the addresses listed in the instructions of the tax return with which this form is filed.

## General Instructions

### Purpose of Form

Form 8582 is used to figure the amount of any passive activity loss for the current tax year and the amount of losses from passive activities allowed on your tax return. You have a passive activity loss for the year if the total losses (including prior year unallowed losses) from all of your passive activities exceed the total income from all of your passive activities.

### Changes You Should Note

Personal service corporations and closely held C corporations subject to the passive activity rules should use new **Form 8810**, Corporate Passive Activity Loss and Credit Limitations, instead of Form 8582, and **Form 8582-CR**, Passive Activity Credit Limitations.

• The Technical and Miscellaneous Revenue Act of 1988 provides that an election can be made to treat investment interest expense from a passive activity as either passive activity interest or as investment interest expense. This applies only to investment interest expense attributable to those activities which was disallowed in 1986 and carried forward to 1987 and which would have been treated as a passive activity deduction for 1986 if the passive activity rules had been in effect before 1987. If you elect to treat the investment interest expense as passive activity interest expense, file **Form 1040X**, Amended U.S. Individual Income Tax Return, or an amended **Form 1041**,

U.S. Fiduciary Income Tax Return. Refigure your investment interest expense for 1987 and your passive activity loss for 1987 by modifying a 1988 Form 4952 and a 1988 Form 8582 as explained in the instructions on page 15.

• The Act also provides that for tax years beginning after 1986, a gain from an installment sale that was from an activity that would have been a passive activity if the passive activity rules would have been in effect before 1987, is passive activity income and can be used to offset passive activity losses.

### Who Must File

Form 8582 is filed by individual taxpayers, estates, and trusts who have passive activities. You do not have to file Form 8582 if you meet **Exception 1** or **2** below.

#### Exception 1:

You have an overall gain when you combine all of your net income and net losses (including any prior year unallowed losses) from business or rental passive activities.

In figuring your net income or net loss from all passive activities for the year, **do not** include the following:

1. Net income that is not passive activity income. See **Passive Activity Income** on page 4.
2. Net losses that are not passive activity net losses. See **Activities That Are Not Passive Activities** on page 2.
3. Net income or net loss from your interest in any publicly traded partnership. See **Publicly Traded Partnerships (PTPs)** on page 6 of these instructions.
4. Any overall loss from a passive activity that results when you combine any net gain or net loss on an entire disposition with any current year operating net income or loss for the activity and any prior year unallowed losses. See **Dispositions** on page 6.

#### Exception 2:

You actively participated in rental real estate activities and you meet **ALL** of the following conditions:

- The rental real estate activities with active participation were your only passive activities.
- You have no prior year unallowed losses from these activities.
- Your total loss from the rental real estate activities was not more than \$25,000 (\$12,500 if married filing separately and you lived apart from your spouse all year).
- If you are married filing separately, you lived apart from your spouse all year.
- You have no current or prior year unallowed credits from a passive activity.
- Your modified adjusted gross income was not more than \$100,000 (\$50,000 if

married filing separately and you lived apart from your spouse all year).

For the definition of modified adjusted gross income, see the line 6 instructions on page 11.

If you meet all of the conditions listed above, your rental real estate losses are not limited. Enter the amount of the loss from line 23 of Schedule E on line 24 of Schedule E and do not complete Form 8582.

If you don't meet Exception 1 or 2, you must complete Form 8582.

### Overview of Form

The form consists of three parts.

**Part I.—Computation of 1988 Passive Activity Loss.** Use Part I to combine the net income and net loss from all passive activities to determine if you have a passive activity loss for 1988.

If the net losses from all passive activities exceed the net income from all passive activities, you will have a passive activity loss for 1988.

**Part II.—Computation of the Special Allowance for Rental Real Estate With Active Participation.** Use Part II to figure the maximum amount of rental loss allowed if you have a net loss from a rental real estate activity with active participation. (See **Rental Activities** on page 2 for details.)

**Part III.—Computation of Passive Activity Loss Allowed.** Use Part III to figure the amount of the passive activity loss (as determined in Part I) that is allowed for 1988 for all passive activities.

### Passive Activity Losses

Passive activity losses cannot be used to offset income from nonpassive activities. However, a special allowance for rental real estate activities with active participation allows losses even if the losses exceed passive income. These rules are discussed in more detail on page 3.

Passive activity losses that are not allowed in the current year are carried forward until they are allowed either against passive activity income or against the special allowance, if applicable. They are also used when you sell or exchange your entire interest in the activity in a fully taxable transaction to an unrelated party.

### Meaning of Terms

Except as otherwise indicated, the following terms in these instructions have the following meanings:

**Net income** means the excess of income over deductions.

**Net loss** means the excess of deductions over income.

**Overall gain** means the excess of all net income from the activity over all net losses

from the activity. This includes net income or loss from the current year operations of the activity, any gain or loss on a disposition, and any prior year unallowed losses.

**Overall loss** means the excess of all net losses from the activity over all net income from the activity. This includes net income or loss from the current year operations of the activity, any gain or loss on a disposition, and any prior year unallowed losses.

**Prior year unallowed losses** means the net losses from an activity that were disallowed under the passive activity loss limitations in a prior year and carried forward to the tax year under section 469(b). See Temporary Regulations section 1.469-1T(f)(4) and **Pub. 925**, Passive Activity and At-Risk Rules.

## Coordination With Other Limitations

Losses from passive activities generally are subject to other applicable limitations (for example, basis and at-risk limitations) before they are subject to the passive loss limitation. Once a loss becomes allowable under these other limitations, you must determine whether the loss is limited under the passive loss rules. Get **Form 6198**, Computation of Deductible Loss from an Activity Described in Section 465(c), for details on the at-risk rules. Capital losses that are allowable under the passive loss rules, however, may be limited under section 1211.

## Instructions To Read Before Completing Form 8582

To see if your activity is treated as a passive activity, read:

- **Passive Activities** (see below).
- **Trade or Business Activities** if your activity is a trade or business (page 3).
- **Rental Activities** if your activity is the renting of tangible property (see below).
- **Recharacterization of Passive Income** if your activity is a trade or business or a rental activity (page 5).

To see how to treat income from your activity, read:

- **Passive Activity Income and Deductions, Passive Activity Income, Passive Activity Deductions, and Dispositions** (pages 4 through 6).

To see how to report net income and net losses on the forms and schedules, read:

- The instructions for line 19 (page 11).
- The instructions for Worksheets 3 through 6 (pages 12 through 14).

## Passive Activities

There are two kinds of passive activities: trade or business activities in which you did not materially participate for the tax year, and rental activities regardless of your participation. See **Trade or Business Activities** on page 3 and **Rental Activities** on this page.

**Caution:** *The passive activity loss rules limit losses from an "activity." Rules for identifying activities for purposes of the limitations will be provided in Temporary Regulations section 1.469-4T, which had not been published as of the time these instructions went to print.*

## Activities That Are Not Passive Activities

The following are not passive activities:

1. Trade or business activities in which you materially participated for the tax year.
2. An interest in an oil or gas well drilled or operated pursuant to a working interest if at any time during the tax year you held the working interest directly or through an entity that did not limit your liability (such as a general partner interest in a partnership). This exception applies regardless of whether you materially participated in the activity for the tax year.

If, however, your liability was not unlimited for the entire year (for example, you converted your general partner interest to a limited partner interest during the year), some of your income and losses from the working interest may be treated as passive activity gross income and passive activity deductions. See Temporary Regulations section 1.469-1T(e)(4)(ii).

3. The rental of a dwelling unit that was also used for personal purposes. This exception applies if you rented out a dwelling unit that you also used as a home during the year for a number of days which exceeds the greater of 14 days or 10 percent of the number of days during the year that the home was rented at a fair rental.

4. An activity of trading personal property for the account of owners of interests in the activity. See Temporary Regulations section 1.469-1T(e)(6).

### Low-Income Housing Activities.—

Transitional relief is provided in the case of low-income housing activities. Losses from certain investments after 1983 in low-income housing are not treated as from a passive activity for a period of up to 7 years from the date of your original investment. See **Pub. 925** for more details. Also see **Passive Activity Income** on page 4.

Income and losses from these activities should not be entered on Form 8582 but may be subject to limitations other than the passive loss rules.

## Rental Activities

A rental activity is a passive activity even if you materially participated in the activity.

However, if you meet any one of the six exceptions listed below, the rental of the property is not treated as a rental activity. See **How To Report Net Income and Losses from the Activities** on page 3.

An activity is a rental activity if tangible property (real or personal) is used by customers or held for use by customers and the gross income (or expected gross income) from the activity represents amounts paid (or to be paid) mainly for the use of the property, regardless of whether the use is under a lease, a service contract or some other arrangement that is not called a lease.

### Exceptions

An activity is not a rental activity if:

1. The average period of customer use of the rental property is seven days or less.

**The average period of customer use** is figured by dividing the total number of days in all rental periods by the number of rentals during the tax year.

2. The **average period of customer use** (see definition in 1) of the rental property is 30 days or less and **significant personal services** were provided in connection with making the rental property available for customer use.

**Significant personal services** include only services performed by individuals, but do not include **excluded services** (see definition below). In determining whether personal services are significant, all of the relevant facts and circumstances are taken into consideration. Facts and circumstances include the frequency of the services, the type and amount of labor required to perform the services, and the value of the services relative to the amount charged for use of the property.

**Excluded services** in connection with the use of rental property are:

- a. Services necessary to permit lawful use of the rental property.
- b. Services performed in connection with improvements or repairs to the rental property that extend the useful life of the property substantially beyond the average rental period.
- c. Services provided in connection with the use of any improved real property that are similar to those commonly provided in connection with long-term rentals of high-grade commercial or residential property (for example, cleaning and maintenance of common areas and routine repairs).

3. **Extraordinary personal services** were provided in connection with making the rental property available for customer use.

Services provided in connection with making rental property available for customer use are **extraordinary personal services** only if the services are performed by individuals and the customer use of the rental property is incidental to their receipt of the services.

4. The rental of the property is **incidental** to a nonrental activity.

The rental of property is **incidental** to an activity of holding property for investment if the main purpose of holding the property is to realize a gain from the appreciation of the property and the gross rental income is less than the smaller of 2% of the **unadjusted basis** of the property or 2% of the fair market value of the property.

**Unadjusted basis** means the cost of the property without reducing it by depreciation or any other adjustment described in section 1016 that reduces basis.

The rental of property is **incidental** to a trade or business activity if:

- a. You own an interest in the trade or business activity at all times during the year; and
- b. The rental property was mainly used in the trade or business activity during the tax year or during at least two of the five preceding tax years; and
- c. The gross rental income from the property is less than the smaller of 2% of the **unadjusted basis** of the property or 2% of the fair market value of the property.

The rental of property during the tax year in which it is sold or exchanged (in a transaction in which gain or loss is recognized) is **incidental** to an activity of dealing in the property if at the time of the

sale or exchange you held the property primarily for sale to customers in the ordinary course of a trade or business.

Lodging provided for the employer's convenience to an employee or the employee's spouse or dependents is **incidental** to the activity or activities in which the employee performs services.

**5.** You customarily make the rental property available during defined business hours for nonexclusive use by various customers.

**6.** You provide property for use in a nonrental activity of a partnership, an S corporation, or joint venture in which you own an interest.

For example, if a partner contributes the use of property to a partnership, none of the partner's distributive share of partnership income is income from a rental activity unless the partnership is engaged in a rental activity. In addition, a partner's gross income attributable to a guaranteed payment under section 707(c) is not income from a rental activity. The determination of whether the property used in the activity is provided in the partner's capacity as an owner of an interest in the partnership is made on the basis of all the facts and circumstances.

### How To Report Net Income and Losses from the Activities

If you meet any of the six exceptions listed above, your rental of the property is not a rental activity. You must then determine whether your rental of the property is a trade or business activity and, if so, whether you materially participated in the activity for the tax year (see **Trade or Business Activities** below). If the activity is a trade or business activity in which you did not materially participate, enter the income and losses from the activity in Worksheet 2 on page 10.

If you meet any of the exceptions listed above and your rental of the property is a trade or business activity in which you materially participated, report any income or loss from the activity on the form or schedule you normally use. If you meet any of the exceptions listed above and your rental of the property is not a trade or business activity, report any income or loss from the activity on the form or schedule you normally use.

If you **did not** meet any of the six exceptions, the rental activity is a passive activity. Special rules apply if you conduct the rental activity through a publicly traded partnership (PTP) or if any of the rules described under **Recharacterization of Passive Income** on page 5 apply. See the PTP rules on page 6.

If none of the special rules apply, the rental activity is entered on either Worksheet 1 or 2 on page 10. Worksheet 1 is for rental real estate activities in which you actively participated. See **Active Participation in a Rental Real Estate Activity** below. Worksheet 2 is for rental real estate activities in which you did not actively participate, rental of personal property activities, and other trade or business activities for which you did not materially participate. See the instructions for that worksheet on page 10.

## Active Participation in a Rental Real Estate Activity

If you actively participated in a rental real estate activity, you can deduct the net loss from the activity from up to \$25,000 of nonpassive income. This is an exception to the general rule disallowing losses in excess of income from passive activities. The exception is not available if you were married for the tax year, file a separate return for the year, and did not live apart from your spouse at all times during the year.

Only individuals and qualifying estates can actively participate in a rental real estate activity. Estates (other than qualifying estates) and trusts cannot actively participate. Limited partners cannot actively participate unless future regulations provide an exception.

You did not actively participate in a rental real estate activity if at any time during the tax year your interest (including your spouse's interest) in the activity was less than 10% (by value) of all interests in the activity.

Active participation is a less stringent requirement than material participation (see **Material Participation** below). You may be treated as actively participating if you participated, for example, in making management decisions or arranging for others to provide services (such as repairs) in a significant and bona fide sense. Management decisions that are relevant in this context include approving new tenants, deciding on rental terms, approving capital or repair expenditures, and other similar decisions.

**Caution:** *Future regulations will define "active participation."*

A qualifying estate is treated as actively participating for the 2 years following the taxpayer's death if the taxpayer actively participated in the rental real estate activity for the taxable year in which the taxpayer died.

Single individuals and married individuals filing a joint return for the tax year can qualify for up to \$25,000 of the special allowance. Married individuals who file separate returns for the tax year and who lived apart at all times during the year can qualify for up to \$12,500 of the special allowance. A qualifying estate that files a joint return with the surviving spouse is entitled to up to \$25,000 of the special allowance. If the estate and the surviving spouse file separate returns, each may qualify for up to \$12,500 of the allowance.

The special allowance phases out at the rate of \$.50 for each dollar by which your modified adjusted gross income for the tax year exceeds \$100,000 (\$50,000 in the case of married filing separately). See line 6 instructions on page 11 for the definition of "modified adjusted gross income."

If you qualify under the active participation rules, use Worksheet 1 on page 10 of the instructions.

## Trade or Business Activities

An activity is a trade or business activity if the activity is not treated as a rental activity and:

1. The activity involves the conduct of a trade or business (i.e., deductions from the activity would be allowable under section 162 if other limitations, such as the passive loss rules, did not apply), or
2. Research or experimental expenditures in the activity are deductible if you choose to deduct rather than capitalize them. Trade or business activities are generally reported on Schedules C, F, and Part II or III of Schedule E.

## Material Participation

**Individuals.**—You materially participated for the tax year in a trade or business activity if you satisfy one or more of the following tests:

1. You participated in the activity for more than 500 hours.
2. Your participation in the activity for the tax year (including individuals who did not own any interest in the activity) was substantially all of the participation in the activity of all individuals for the year.
3. You participated in the activity for more than 100 hours during the tax year, and you participated at least as much as any other individual (including individuals who did not own any interest in the activity) for the year.
4. The activity is a significant participation activity for the tax year, and you participated in all significant participation activities during the year for more than 500 hours. A significant participation activity is any trade or business activity in which you participated for more than 100 hours during the year and in which you did not materially participate under any of the material participation tests (other than this test 4).
5. You materially participated in the activity for any 5 (whether or not consecutive) of the 10 preceding tax years. When determining whether you materially participated in tax years beginning before 1987 (other than a tax year of a partnership, an S corporation, an estate, or a trust ending after 1986), you materially participated only if you participated for more than 500 hours during the tax year.
6. The activity is a personal service activity in which you materially participated for any 3 (whether or not consecutive) preceding tax years. When determining whether you materially participated for tax years beginning before 1987 (other than a tax year of a partnership, an S corporation, an estate, or a trust ending after 1986), you materially participated only if it was for more than 500 hours during the tax year.

An activity is a personal service activity if it involves the performance of personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, or any other trade or business, in which capital is not a material income-producing factor.

7. Based on all of the facts and circumstances, you participated in the activity on a regular, continuous, and substantial basis during the tax year.

You did not materially participate in the activity under this seventh test, however, if:

- a. You participated in the activity for 100 hours or less during the year, or
- b. Any person besides yourself received compensation for performing services in the management of the activity, or
- c. Any individuals beside yourself spent more hours during the tax year than you spent performing services in the management of the activity (regardless of whether the individual was compensated for the management services).

**Caution:** Future regulations will provide additional rules for determining whether you materially participated under the seventh test.

**Participation.**—Participation for purposes of the material participation test generally includes any work you did (without regard to the capacity in which you did it) in connection with an activity in which you owned (directly or indirectly, other than through a C corporation) an interest at the time you did the work. Work is not treated as participation, however, if the work is not work that an owner of that type of activity would customarily do, and one of your main purposes for doing the work was to avoid the disallowance of losses or credits from the activity under the passive loss rules.

Work you did as an investor in an activity is not treated as participation unless you were directly involved in the day-to-day management or operations of the activity. Work done as an investor includes:

- a. Studying and reviewing financial statements or reports on operations of the activity.
- b. Preparing or compiling summaries or analyses of the finances or operations of the activity for your own use.
- c. Monitoring the finances or operations of the activity in a nonmanagerial capacity.

**Participation of spouse.**—If you are married for the tax year, your participation in an activity includes any participation in the activity during the tax year by your spouse, regardless of whether your spouse owned any interest in the activity and regardless of whether you and your spouse file a joint return for the tax year.

**Proof of participation.**—You may prove your participation in an activity by any reasonable means. You do not have to maintain contemporaneous daily time reports, logs, or similar documents if you can establish your participation by other reasonable means. Reasonable means for this purpose may include, but are not limited to, the identification of services performed over a period of time and the approximate number of hours spent performing the services during that period, based on appointment books, calendars, or narrative summaries.

**Limited partners.**—If you owned your interest in an activity as a limited partner, you generally did not materially participate in the activity. You did materially participate in the activity, however, if you materially participated in the activity under test 1, 5, or 6 above for the tax year.

You are not treated as a limited partner, however, if you were a general partner in the partnership at all times during the partnership's tax year ending with or within your tax year (or, if shorter, during the

portion of the partnership's tax year in which you directly or indirectly owned your limited partner interest).

**Certain retired or disabled farmers and surviving spouse of farmers.**—Certain retired or disabled farmers are treated as materially participating in a farming activity if they materially participated for a total of 5 years out of the 8 years before retirement or disability. Similarly, a surviving spouse is treated as materially participating in a farming activity if the real property used in the activity meets the estate tax rules for special valuation of farm property passed from a qualifying decedent and the surviving spouse actively manages the farm.

**Estates and trusts.**—The passive loss limitations apply in computing the distributable net income and taxable income of an estate or trust. See Temporary Regulations section 1.469-1T(b)(2) and (3). Future regulations will explain how to determine material participation for this purpose.

### How To Report Net Income and Losses from Trade or Business Activities

**Trade or business activities with material participation.**—If you materially participated in a trade or business activity, the activity is **not** a passive activity. Report the income and losses from the activity on the form or schedule you normally use.

**Trade or business activities without material participation.**—If you did not materially participate in a trade or business activity, the activity is a passive activity. In general, you must use Worksheet 2 on page 10 to determine the amount to enter on Form 8582. However, if you held the activity through a publicly traded partnership or the activity is a significant participation activity, special rules apply. See **Publicly Traded Partnerships (PTPs)** on page 6, and **Significant Participation Passive Activities** on page 7 for how to report net income or losses from these activities.

### Passive Activity Income and Deductions

Take into account only passive activity gross income and passive activity deductions in determining your net income or net loss from all passive activities or any passive activity. For example, if your passive activity is reported on Schedule C, E, or F, take into account only the passive activity gross income and passive activity deductions from the activity in determining the amount to enter on Form 8582 and the worksheets.

If you own an interest in a passive activity through a partnership or an S corporation, the partnership or S corporation will generally provide you with the net income or net loss from the passive activity. If, however, the partnership or S corporation is required to state an item of gross income or deduction separately to you, and the gross income or deduction is passive activity gross income or a passive activity deduction (respectively), you must include that amount in computing the net income or net loss entered on Form 8582 and the worksheets.

### Passive Activity Income

In determining your net income or net loss from all passive activities or any passive

activity, take into account only passive activity income. Do not enter income that is not passive activity income on Form 8582 or the worksheets. Passive activity income includes all income from passive activities, including (with certain exceptions described in Temporary Regulations section 1.469-2T(c)(2)) gain from the disposition of an interest in a passive activity or property used in a passive activity at the time of the disposition.

Passive activity income **does not** include the following:

- Income from an activity that is not a passive activity. See **Activities That Are Not Passive Activities** on page 2.
- Gain from the disposition of substantially appreciated property formerly used in a nonpassive activity unless the property was used in a passive activity for either 20% of the period you held the property or the entire 24-month period ending on the disposition date. See Temporary Regulations section 1.469-2T(c)(2)(iii).
- Portfolio income, including interest, dividends, annuities, and royalties not derived in the ordinary course of a trade or business and gain or loss from the disposition of property that produces those types of income or is held for investment (see section 163(d)(5)). See Temporary Regulations section 1.469-2T(c)(3).
- Personal service income, including salaries, wages, commissions, self-employment income from trade or business activities in which you materially participated for the tax year, deferred compensation, taxable social security and other retirement benefits, and payments from partnerships to partners for personal services. See Temporary Regulations section 1.469-2T(c)(4).
- Income from positive section 481 adjustments allocated to activities other than passive activities. See Temporary Regulations section 1.469-2T(c)(5).
- Income or gain from investments of working capital.
- Income from an oil or gas property if you treated any loss from a working interest in the property for any tax year beginning after 1986 as a nonpassive loss under the rule excluding working interests in oil and gas wells from passive activities. See Temporary Regulations section 1.469-2T(c)(6).
- Any income from intangible property if your personal efforts significantly contributed to the creation of the property.
- Income from a qualified low-income housing project (see section 502 of the Tax Reform Act of 1986) for any year in which losses from the project would not be subject to the passive loss limitations under the special transitional rule for certain low-income housing projects.
- Net income treated as income that is not passive activity income under Temporary Regulations section 1.469-2T(f). See **Recharacterization of Passive Income** on page 5.
- Net passive income from any interest in a publicly traded partnership. See **Publicly Traded Partnerships (PTPs)** on page 6.
- State, local, and foreign income tax refund.
- Income from a covenant not to compete.

## Passive Activity Deductions

In determining your net income or net loss from all passive activities or any passive activity, take into account only passive activity deductions. Do not take into account deductions that are not passive activity deductions. Passive activity deductions include all deductions from activities that are passive activities for the tax year and all deductions from passive activities that were disallowed under the passive loss rules in prior tax years beginning after 1986 and carried forward to the tax year under section 469(b). See Temporary Regulations section 1.469-1T(f)(4).

Passive activity deductions include losses from dispositions of property used in a passive activity at the time of the disposition and losses from a disposition of less than your entire interest in a passive activity. See **Dispositions** below for the treatment of losses upon certain dispositions of your entire interest in an activity.

Passive activity deductions **do not** include the following:

- Deductions for expenses (other than interest expense) that are clearly and directly allocable to portfolio income.
- Dividends received deductions for dividends not included in passive activity gross income.
- Interest expense, other than interest expense properly allocable under Temporary Regulations section 1.163-8T to passive activities (for example, qualified home mortgage interest and capitalized interest expense are not passive activity deductions).
- Losses from dispositions of property that produce portfolio income or property held for investment.
- State, local, and foreign income taxes.
- Miscellaneous itemized deductions that may be disallowed under section 67.
- Charitable contribution deductions.
- Net operating loss and capital loss carryforwards.
- Deductions and losses that would have been allowed for tax years beginning before 1987 but for basis or at-risk limitations.
- Losses from section 481 adjustments allocated to activities other than passive activities. See Temporary Regulations section 1.469-2T(d)(7).

## Recharacterization of Passive Income

Passive activity gross income does not include net income from certain types of passive activities and property used in certain types of passive activities described below. If during the tax year you were in a passive activity or used property in a passive activity described below (either directly or through a partnership or an S corporation), combine the income and losses from the activity or property before entering any amounts on any of the worksheets in these instructions.

If the result is a **net loss**, treat the income and losses the same as any income or losses from that type of passive activity (trade or business activity or rental activity).

If the result is **net income**, do not enter any of the income or losses from the activity or property on Form 8582 or the worksheets. Instead, enter them on the form and schedules you normally use, and see **Treatment of net income** below.

**Significant participation passive activities.**—If your passive activity gross income from significant participation passive activities exceeds your passive activity deductions from those activities, a ratable portion of your net income from each significant participation passive activity is treated as nonpassive income. See Worksheet A on page 8. A significant participation passive activity is any trade or business activity (as defined on page 3) in which you participated for more than 100 hours during the tax year and did not materially participate (see **Material Participation** on page 3). See the instructions for reporting income and losses from significant participation passive activities on page 7.

**Note:** All of the items from the activities listed below apply for tax years beginning after December 31, 1987.

**Nondepreciable rental property.**—If you have net income (including prior year unallowed losses) from renting property and less than 30 percent of the unadjusted basis of the property is subject to depreciation under section 167, the net income is treated as nonpassive income.

If you have an overall loss (including prior year unallowed losses) from this activity, the overall loss is treated like any other passive activity loss. Use Worksheet 1 if you qualify for active participation in the activity or Worksheet 2 if you do not qualify for active participation.

See Temporary Regulations section 1.469-2T(f)(3) for more information on nondepreciable rental property.

**Equity-financed lending activities.**—If you have net income from an equity-financed lending activity, the lesser of the net income or the equity-financed interest income is nonpassive income.

See Temporary Regulations section 1.469-2T(f)(4) for more information on equity-financed lending activities.

**Rental of property incidental to a development activity.**—Net income from this type of activity will be treated as nonpassive income if **all** of the following apply:

- a. You recognize gain from the sale, exchange, or other disposition of the rental property during the tax year.
- b. The use of the item of property in the rental activity started less than 24 months before the date of disposition. (The use of an item of rental property begins when substantially all of the property is first held out for rent and is in a state of readiness for rental.)
- c. You materially participated (without regard to whether you were a limited partner) or significantly participated for any tax year in an activity that involved the performance of services for the purpose of enhancing the value of the property (or any other item of property, if the basis of the property disposed of is determined in whole or in part by reference to the basis of that item of property).

See Temporary Regulations section 1.469-2T(f)(5) for more information on rental of property incidental to a development activity.

**Property rented to a nonpassive activity.**—If you rent property to a trade or business activity in which you materially participated, net rental income from the property is treated as nonpassive income.

This rule does not apply to net income from renting property under a written binding contract entered into before February 19, 1988.

**Acquisition of an interest in a passthrough entity that licenses intangible property.**—Net royalty income from intangible property held by a passthrough entity in which you own an interest is treated as nonpassive royalty income if you acquired your interest in the passthrough entity after the partnership, S corporation, estate, or trust created the intangible property or performed substantial services or incurred substantial costs for developing or marketing the intangible property.

This recharacterization rule does not apply if:

- a. The expenditures the entity reasonably incurred in developing or marketing the property exceed 50% of the gross royalties from licensing the property that are includible in your gross income for the tax year, or
- b. At the time you acquired your interest in the passthrough entity, your share of the expenditures the entity reasonably incurred in developing or marketing the property for all taxable years exceeded 25% of the fair market value of your interest in the intangible property.

For purposes of the rule in **b.** above, capital expenditures are taken into account for the entity's tax year that the expenditure is chargeable to a capital account, and your share of the expenditure is figured as if the expenditure was allowed as a deduction for the tax year.

**Limitation on recharacterized passive income.**—If net income from an activity is subject to recharacterization as nonpassive income under two or more of the rules described above for **Significant participation passive activities**, **Nondepreciable rental property**, or **Equity-financed lending activities**, the amount of net income that is recharacterized cannot exceed the most net income that is treated as nonpassive income under any one of those rules. See Temporary Regulations section 1.469-2T(f)(8).

**Treatment of net income.**—If any of the activities listed under the recharacterization of passive income rules had net income that is nonpassive, do not enter any net income or loss from the activity on Form 8582. The net income and losses are reported on the form or schedule that you normally use. However, if you must complete Form 8582 because you have other passive activities, see the specific instructions for line 12.

**Investment income and investment expense.**—For purposes of computing your investment interest expense limitation on **Form 4952**, Investment Interest Expense Deduction, treat as investment income any



passive income recharacterized as nonpassive income from nondepreciable rental property, an equity-financed lending activity, or a passthrough entity's activity of licensing intangible property.

## Dispositions

### Disposition of less than an entire interest.

**Interest.**—Gains and losses from the disposition of less than an entire interest in an activity are treated as part of the overall gain or loss from the activity for the current year. A disposition of less than an entire interest does not trigger the allowance of prior year unallowed losses. See the instructions for Part I and Worksheets 1 and 2 on page 10 for how to make the entries on Form 8582.

**Disposition of an entire interest.**—If you disposed of your entire interest in a passive activity or a former passive activity to an unrelated person in a fully taxable transaction during the tax year, your losses allocable to the activity for the year are not limited by the passive loss rules. A fully taxable transaction is a transaction in which you recognize all of your realized gain or loss.

**Note:** A partner in a publicly traded partnership (PTP) is not treated as having disposed of an entire interest in an activity of a PTP until there is an entire disposition of the partner's interest in the PTP.

### Reporting an entire disposition on Schedule D or Form 4797.

—When you completely dispose of your entire interest in a passive activity, you may have to report current year net income or loss from the activity, prior year unallowed losses, and gain or loss on the disposition. All of the net income and losses are reported on the forms and schedules you normally use.

Combine any gains and losses (including any prior year unallowed losses) allocable to the activity for the tax year to see if you have an overall gain or loss. If you have an overall gain and you have other passive activities to report on Form 8582, include the income and losses in Worksheet 1 or 2. If this is your only passive activity, report any gains and losses (including any prior year unallowed losses) on the forms and schedules you normally use and skip the worksheets and Form 8582.

If you have an overall loss when you combine the gains and losses, do not use the worksheets or Form 8582 for the activity. Any losses (including prior year unallowed losses) are allowed in full. Report the gains and losses on the forms and schedules you normally use.

If you must figure modified adjusted gross income for line 6 of Form 8582, the overall loss from this activity is a nonpassive activity loss and must be used in the modified adjusted gross income computation.

## Example 1

You sell your entire interest in a rental property at a gain of \$15,525. \$7,300 of the gain is section 1231 gain (Form 4797, Part I) and \$8,225 is ordinary recapture income (Form 4797, Part II). The total loss to be reported on line 24 of Schedule E (Form 1040) is (\$15,450). This includes

the (\$2,800) current year loss, and the (\$12,650) prior year unallowed loss.

If you had other passive activities reportable on Form 8582, the following entries would be made in Worksheet 1, Part 1, on page 10. The \$15,525 gain on the disposition is entered in column (a), the current year loss of (\$2,800) is entered in column (b), and the prior year unallowed loss of (\$12,650) is entered in column (c).

## Example 2

You sell your entire interest in a partnership. You have a current year loss of (\$3,330), a prior year unallowed loss of (\$1,115), and a \$2,000 gain on the sale of your interest in the partnership.

Since there is an overall loss of (\$2,445) after combining the gain and losses, none of the amounts are entered on Form 8582.

The current year loss plus the prior year unallowed loss of (\$4,445) is entered on Schedule E, Part II, column (i), and the \$2,000 gain on the sale is entered on Schedule D, either in Part I or Part II, depending on how long the partnership interest was held.

## Publicly Traded Partnerships (PTPs)

A publicly traded partnership (PTP) is a partnership whose interests are traded on an established securities market or are readily tradable on a secondary market (or the substantial equivalent).

An established securities market includes any national securities exchange and any local exchange registered under the Securities Exchange Act of 1934 or exempted from registration because of the limited volume of transactions. It also includes any over-the-counter market.

A secondary market is generally indicated by the existence of a person standing ready to make a market in the interest. An interest is treated as readily tradable if the interest is regularly quoted by persons, such as brokers or dealers, who are making a market in the interest.

The substantial equivalent of a secondary market exists where there is not an identifiable market maker, but the holder of an interest has a readily available, regular, and ongoing opportunity to sell or exchange his or her interest through a public means of obtaining or providing information of offer to buy, sell, or exchange interests. Similarly, the substantial equivalent of a secondary market exists where the prospective buyers and sellers have the opportunity to buy, sell, or exchange interests in a time frame and with the regularity and continuity that the existence of a market maker would provide.

**Note:** Future regulations will provide that interests in a partnership are not treated as readily tradable on a secondary market or the substantial equivalent thereof under the circumstances and by reason of the transactions described in Notice 88-75, 1988-27 I.R.B. 29 (July 5, 1988).

## Special Instructions for PTPs.—

Section 469(k) provides that section 469 must be applied separately to items from each PTP. Losses from passive activities held through a PTP generally can only be used to offset income or gain from passive activities of the same PTP.

Partners in PTPs must be able to identify which items of income and loss are from passive activities and whether or not these items of income or loss qualify for the passive loss phase-in provisions.

For tax years 1987 through 1990, losses from pre-enactment interests in passive activities are eligible for a gradual phase-in of the passive activity loss limitations.

A **pre-enactment** interest is a qualified interest in a pre-enactment activity. A qualified interest is any interest in an activity that you held on October 22, 1986, and have held at all times since that date, or any interest in an activity that you acquired after October 22, 1986, under one or more written binding contracts that you were a party to on October 22, 1986, and that you have held at all times since you acquired the interest. An activity is a pre-enactment activity if it was being conducted by any person on October 22, 1986, or at least 50% (by value) of the property used in the activity during the tax year was in existence or under construction on August 16, 1986, or acquired or constructed by any person under a written binding contract in effect on August 16, 1986. A partner's losses are from pre-enactment interests only if the activity is a pre-enactment interest of both the partnership and the partner. See Temporary Regulations section 1.469-11T(c) for more information on pre-enactment interests held through a PTP and the phase-in rule.

## Passive Activity Loss Rules for Partners in PTPs.

—Do not include any income or loss from PTP passive activities on Form 8582. Instead, use the following rules to compute and report in Part II of Schedule E your net income or net loss from the PTP passive activity or activities you held through each PTP that you owned an interest in during the tax year:

1. Combine any current year income, current year losses, and prior year unallowed losses to see if you have an overall gain or loss. Include only the same types of income and losses you would include in figuring your net income or loss from a non-PTP passive activity (see **Passive Activity Income and Deductions** on page 4 of these instructions).

2. If you have an overall gain, the net gain portion (total gain minus total losses) is nonpassive income. When reporting the income and loss on the forms and schedules, identify the net gain portion as nonpassive income and the remaining income and the total losses as passive income and loss. Write to the left of the entry space, "From PTP." It is important to identify the nonpassive income because the nonpassive portion is included in modified adjusted gross income on line 6 of Form 8582. In addition, the nonpassive income is included in investment income for purposes of figuring your investment interest expense deduction on Form 4952.

For example, if you have Schedule E income of \$10,000, Schedule E current year losses of \$2,000, and Schedule E prior year unallowed losses of \$3,500 from the PTP passive activities of a particular PTP, you have a \$4,500 overall gain (\$10,000 – \$2,000 – \$3,500). In Schedule E, Part II, report the \$4,500 "From PTP"

net gain as nonpassive income in column (k), the \$5,500 of losses in column (g), and \$5,500 of the gain in column (h).

3. If you have an overall loss (other than an entire disposition), the losses are allowed to the extent of the income, and the excess loss is carried forward to use in a future year when you have income to offset it. Report the portion of the loss that does not exceed the income in column (g), and report the income in column (h). If, however, the loss is from a pre-enactment interest, see **Pre-enactment Interest with**

**Net Loss** below to determine if any of the loss in excess of the income is allowed under the passive loss phase-in rule.

For example, for a post-enactment interest, if you have a Schedule E loss of \$12,000 (current year losses plus prior year unallowed losses) and Schedule E income of \$7,200, in Schedule E, Part II, report \$7,200 of the losses in column (g) and the \$7,200 of income in column (h). Carry forward the unallowed loss of \$4,800 (\$12,000 – \$7,200).

**Pre-Enactment Interest with Net Loss.**—If you have a net loss from a PTP passive activity, the partnership advised you that the partnership has a pre-enactment interest in the activity, and you have a pre-enactment interest in the activity, the loss may be allowed under the passive loss phase-in rule. Compute the allowed phase-in loss using the schedule below. In addition, if you are filing Form 4952, any allowed phase-in loss must be included on line 3 of that form.

**Computation of Phase-in Rule for Publicly Traded Partnerships (PTP)**

If you owned an interest in more than one PTP during the tax year, this computation must be made separately for each PTP. Use lines 1a and 1b for current year net income and loss from activities in which the partnership and you have a pre-enactment interest. Use lines 2a and 2b for current year net income and loss from activities in which the partnership does not have a pre-enactment interest. Enter any prior year unallowed losses from all activities on line 2c.

Complete lines 1a through 9 below only if you have an overall loss from passive activities held through a PTP.

1a Activities with net income . . . . .	1a		
b Activities with net loss . . . . .	1b		
c Combine lines 1a and 1b . . . . .		1c	
2a Activities with net income . . . . .	2a		
b Activities with net loss . . . . .	2b		
c Prior year unallowed losses . . . . .	2c		
d Combine lines 2a, 2b, and 2c . . . . .		2d	
3 Combine lines 1c and 2d. If the result is an overall gain, stop here and see the instructions above for how to report the income and losses from the activities on Schedule E . . . . .		3	
4 Enter amount from line 1c. If this line is net income, skip to line 7; otherwise go to line 5 . . . . .		4	
5 Enter the smaller of line 3 or 4 . . . . .		5	
6 Multiply line 5 by 40% (.4) and enter the result . . . . .		6	
7 Add income, if any, on lines 1a and 2a and enter the result . . . . .		7	
8 Total loss allowed from this PTP for 1988. Add lines 6 and 7 . . . . .		8	
9 Disallowed losses from this PTP. Subtract line 6 from line 3 . . . . .		9	

Allocate the amount of disallowed losses on line 9 to your PTP passive activities with net losses on a pro-rata basis. Then subtract the pro-rata amount from the total loss to get the allowed loss to report on the form or schedule you normally use. Keep a record of the disallowed amount on line 9 to be used in a future year.

You may use the worksheets provided in the Form 8582 instructions to keep a record of allowed losses for each PTP. To do this, make extra copies of Worksheets 4 and 5. Use Worksheet 6 instead of Worksheet 5 if you have more than one loss to be reported on different forms and schedules. List each activity of the PTP in Worksheet 4. Enter the overall loss from each activity in column (a). The overall loss for an activity is the loss you get after combining all net income and net loss from the activity for the current year and any prior year unallowed loss. Allocate the amount on line 9 above to each of the activities. Complete Worksheet 5 (Worksheet 6 if any of the activities have losses that are reported on more than one form or schedule). Enter the current year loss plus any prior year unallowed losses in column (a) of Worksheet 5 (or Worksheet 6 if applicable). The losses in column (c) of Worksheet 5 (column (e) of Worksheet 6) are the allowed losses to report on the forms and schedules. Both these losses and any income on lines 1a or 2a in the above worksheet should be reported on the forms and schedules you normally use. See the instructions on page 14 for how to report the income and losses on the form or schedule.

**Nonpassive Income from PTPs.**—If you have passive activities to report on Form 8582, your net income from a passive activity held through PTPs that is treated as nonpassive income is included when figuring modified adjusted gross income on line 6 of Form 8582. In addition, if you must complete **Form 4952**, Investment Interest Expense Deduction, any phase-in allowed (40% of the net loss) is included on line 3 of that form.

**Significant Participation Passive Activities**

Use these instructions and complete Worksheet A below if you have any income or losses from any trade or business activity in which you participated for more than 100 hours during the tax year but did not otherwise meet any of material participation tests (see **Significant participation passive activities** on page 5).

Enter the hours you participated in the activity during the tax year in column (a) of Worksheet A and add up the hours you participated in all these activities. If the total hours exceed 500, you materially participated in all the activities for the year. Do not complete the rest of Worksheet A, and report all the income and losses from the activities on the forms and schedules you normally use and not on Form 8582. However, if an activity has prior year unallowed losses, those losses are allowed only to the extent that the activity had current year net income (current year gross income minus current year deductions and losses). Enter any prior year unallowed losses that exceed current year net income in Worksheet 2 of the Form 8582 instructions. The prior year loss from any of these activities is the amount (if any) of unallowed loss for the activity from Worksheet 4, column (c) of your 1987 Form 8582 instructions.

If the total hours in column (a) of Worksheet A do not exceed 500, and you have a loss in column (d), report the income and losses from the activities in the same way as income and losses from any other passive trade or business activities. Use Worksheet 2 on page 10.

If the total hours in column (a) of Worksheet A do not exceed 500, and you have a gain in column (d), none of the gain is passive income. See the instructions for Worksheet A. Report all the current year income and losses and any prior year unallowed losses that were allowed to the extent of current year net income, on the forms and schedules you normally use and not on Form 8582. Include on Form 8582 any prior year unallowed losses from an activity that were not allowed because the activity had a current year loss or the prior year unallowed losses exceeded the current year net income from the activity.

Instructions for Worksheet A

**Column (a).**—Enter the number of hours you participated in each activity and total the column. If the total hours you participated in all the activities exceeds 500, do not complete the rest of Worksheet A, and report all the income and losses from these activities on the forms and schedules you normally use. Also skip Worksheet B.

**Note:** If any of the activities have prior year unallowed losses, the prior year unallowed losses are only allowed to the extent that the activity has current year net income. Any prior year unallowed losses in excess of current year net income or from an activity with a net loss are included in Worksheet 2 on page 10 of the instructions.

**Column (b).**—Enter the current year net loss, if any, from the activity. The current year net loss should not include any prior year unallowed losses. If an activity has a current year net loss, any prior year unallowed losses from that activity are included on Form 8582. See Worksheet 2 on page 10 of the instructions.

**Column (c).**—Enter net income, if any, from the activity. If an activity has current year net income and prior year unallowed losses, reduce the current year net income by the prior year unallowed losses but not below -0-. Include on Form 8582 the amount of the prior year unallowed losses that exceed the current year net income from the activity.

**Note:** The prior year unallowed loss from an activity is the unallowed loss from column (c) of Worksheet 4 in your 1987 Form 8582 instructions.

**Column (d).**—Combine amounts in the total columns for columns (b) and (c) and enter the net income or net loss in column (d). If the total for column (d) is a net loss and the total hours in column (a) do not exceed 500, skip Worksheet B and include the income and losses from activities on Form 8582. Use Worksheet 2 on page 10 of the instructions.

**Total participation is 500 hours or less and overall gain.**—If the total for column (d) of Worksheet A below is net income and you must complete Form 8582 because you have other passive activities to report, complete Worksheet B and the adjustment to line 12 computation below. If you do not have to complete Form 8582, skip Worksheet B and report the net income and net losses from columns (b) and (c) on the forms and schedules you normally use.

Worksheet A for Significant Participation Passive Activities

Name of Activity	(a) Hours of Participation	(b) Net Loss	(c) Net Income	(d) Combine cols. (b) and (c)
Totals . . . . . ▶				



Instructions for Worksheet B

- List only the significant participation passive activities that have net income.
- Column (a).**—Enter the net income of each activity from column (c) of Worksheet A in this column. If you entered -0- in column (c) because the net income was reduced by prior year unallowed losses, enter -0- for that activity in column (a) of this worksheet.
- Column (b).**—Divide each of the individual net income amounts in column (a) by the total of column (a), and enter the ratio for each of the activities in column (b). The total of the ratios should equal 1.00.
- Column (c).**—Multiply the total of column (d) of Worksheet A by each of the ratios in column (b) and enter the results in this column.
- Column (d).**—Subtract column (c) from column (a). To that amount, add the amount, if any, that net income was reduced by prior year unallowed losses. Enter the result in column (d). Also complete the computation for line 12 of Form 8582 which follows this worksheet.

Worksheet B for Significant Participation Activities (Keep for your records.)

Name of activity	(a) Activities with net income	(b) Ratio See instructions.	(c) Nonpassive income See instructions	(d) Passive income Subtract col. (c) from col. (a)
Totals . . . . . ▶		1.00		

Adjustment to Line 12 of Form 8582

- The following adjustment will either increase or decrease the amount on line 12 of Form 8582.
- A.** Add net loss activities that are pre-enactment interests from column (b) of Worksheet A . . . . .
- B.** Add net income activities that are pre-enactment interests, from column (d) of Worksheet B . . . . .
- C.** Combine lines A and B. If the result is net income, subtract it from the tentative amount on line 12 of Form 8582 and enter the difference, but not less than -0-, as the final amount on line 12. If the result is a net loss, add it to the tentative amount on line 12 and enter the total as the final line 12 amount . . . . .

**Note:** Line C in the above computation is an adjustment that has to be made to line 12 of Form 8582. Make the adjustment to line 12 of Form 8582, but report all of the current year income and losses from the activities listed in Worksheet A and any prior year unallowed losses allowed to the extent of current year net income on the forms and schedules you normally use. Do not include these amounts on Form 8582. If any of the activities had prior year unallowed losses that were not allowed, enter those amounts in column (c) of Worksheet 2 on page 10 of the instructions.

Specific Instructions  
Part I

When To Use Worksheet 1

The \$25,000 allowance applies to losses from rental real estate activities. (See **Active Participation in a Rental Real Estate Activity** on page 3.) To be a “rental real estate activity,” the activity must be a “rental real estate activity” (see **Rental Activities** on page 2). For example, if the average period of customer use of the rental property is seven days or less, the activity is not a rental activity or a rental real estate activity, and none of the losses from the activity are allowable under the \$25,000 allowance even if you actively participated in the activity. If this is the case, use Worksheet 2 instead of Worksheet 1 if you do not meet any of the material participation tests under **Trade or Business Activities** on page 3.

**Caution:** Do not enter a prior year unallowed loss in column (c) of Worksheet 1 unless you actively participated in the

activity in both the year the loss arose and the current tax year. If you actively participated in either year but not both years, enter the prior year unallowed loss in column (c) of Worksheet 2.

Individuals and qualifying estates who actively participated in rental real estate activities should include the income or loss from those activities on lines 1a through 1h of Form 8582. Read **Active Participation in a Rental Real Estate Activity** on page 3 of the instructions to see if you actively participated. Use Worksheet 1 to figure the amounts to enter on lines 1a, 1b, 1d, 1e, and 1h if you actively participated in a rental real estate activity. Use Worksheet 2 to figure amounts to enter on lines 2a, 2b, 2d, 2e, and 2h if you did not actively participate in a rental real estate activity.

**Caution:** Married individuals who are filing separate returns and didn’t live apart from their spouse at all times during the tax year do not qualify under the active participation rule and should use Worksheet 2 instead of Worksheet 1.

Instructions for Worksheet 1

- Use Part 1 for pre-enactment interests and Part 2 for post-enactment interests.
- Column (a).**—Enter the net income of each activity. Enter the total of column (a), Part 1, on line 1a of Form 8582. Enter the total of column (a), Part 2, on line 1d of Form 8582.
- Column (b).**—Enter the net loss of each activity. Enter the total of column (b), Part 1 on line 1b of Form 8582. Enter the total of column (b), Part 2, on line 1e of Form 8582.
- Column (c).**—Enter the total of both pre-enactment and other prior year unallowed losses. Enter the total of column (c) for both Parts 1 and 2, on line 1h of Form 8582.
- Columns (d) and (e).**—Combine net income and losses in columns (a) through (c) for each activity and enter any overall gain for the activity in column (d) or any overall loss for the activity in column (e). Do not enter amounts from columns (d) and (e) on Form 8582. These amounts will be used when Form 8582 is completed to figure the loss allowed for the current year.

(Keep for your records.)

**When To Use Worksheet 2**  
Use Worksheet 2 for trade or business activities in which you did not materially participate and for rental real estate activities in which you did not actively participate for the tax year or which did not qualify for the special allowance.

**Worksheet 2—Amounts to enter on lines 2a through 2h.**—Part 1 of Worksheet 2 is used for pre-enactment interests and Part 2 of Worksheet 2 is used for post-enactment interests. The totals from Part 1, columns (a) and (b), are entered on lines 2a and 2b of Form 8582; and the totals from Part 2, columns (a) and (b), are entered on lines 2d and 2e of Form 8582. Column (c) of Worksheet 2 is the total of both pre-enactment and other prior year unallowed losses. The total of this column (Part 1 and Part 2) is entered on line 2h of Form 8582.

Columns (d) and (e) of Worksheet 2 are not entered on Form 8582. These amounts will be used when Form 8582 is completed to determine the allowed loss for the current year.

**Line 2h.**—Enter the total of column (c) from Worksheet 2 on line 2h of Form 8582. Be sure to add all entries in Parts 1 and 2 of column (c).

(Keep for your records.)

Part 1—Pre-enactment Interests	Current year		Prior year	Overall gain or loss	
Name of activity	(a) Net income line 2a	(b) Net loss line 2b	(c) Unallowed loss line 2h	(d) gain	(e) loss
<b>Totals. Enter on lines 2a and 2b . . . ▶</b>					
<b>Part 2—Post-enactment Interests</b>					
Name of activity	(a) Net income line 2d	(b) Net loss line 2e		(d) gain	(e) loss
<b>Totals. Enter on lines 2d, 2e, and 2h . . . ▶</b>					

## Form 8582 Part I (continued)

**Line 3.**—If line 3 shows net income, all of your losses are allowed including any prior year unallowed losses entered on line 1h or 2h. Take the losses to the form or schedule you normally report them on. See page 14 for how to report the losses on the different forms and schedules.

## Parts II and III

Numbers entered in Parts II and III are treated as if they were all positive, that is, greater than zero.

### Examples:

1. Line 1i has a loss of \$47,000 and line 3 has a loss of \$42,000. Enter \$42,000 as a positive number on line 4.
2. Line 4 has a loss of \$42,000 and line 8 is \$25,000. Enter \$25,000 as a positive number on line 9.
3. Line 1c has a loss of \$37,000 and line 8 is \$25,000. Enter \$25,000 as a positive number on line 11.
4. Line 10 is \$32,000 and line 11 is \$25,000. When subtracting line 11 from line 10, the amount to enter on line 12 is \$7,000. Enter it as a positive number.

### Phase-In Rule

For tax years 1987 through 1990, the passive activity loss limitations are phased-in by allowing a declining percentage of the losses from pre-enactment interests in passive activities (net of any losses that are allowed under the \$25,000 allowance for active participation rental real estate activities). The percentage for tax years beginning in 1988 is 40 percent.

A pre-enactment interest is a qualified interest in a pre-enactment activity. A qualified interest is any interest in an activity that you held on October 22, 1986, and have held at all times since that date, or any interest in an activity that you acquired after October 22, 1986, under one or more written binding contracts that you were a party to on October 22, 1986, and that you have held at all times since you acquired the interest.

An activity is a pre-enactment activity if any person was conducting the activity on October 22, 1986, or at least 50 percent (by value) of the property used in the activity during the tax year was either in existence or under construction on August 16, 1986, or acquired or constructed by any person under a written binding contract in effect on August 16, 1986.

In Worksheets 1 and 2, report net income and loss from pre-enactment interests separately from other interests in activities. See Temporary Regulations section 1.469-11T(c) for more information on pre-enactment interests and the phase-in rule.

**Note:** Form 8582 and the instructions refer to "Activities acquired before 10-23-86 (pre-enactment)" and "Activities acquired after 10-22-86 (post-enactment)." An "activity acquired before 10-23-86 (pre-

enactment)" is a pre-enactment interest in an activity, and an "activity acquired after 10-22-86 (post-enactment)" is an interest in an activity other than a pre-enactment interest.

**Line 5.**—Married persons filing separate returns who lived apart at all times during the year should enter \$75,000 on line 5 instead of \$150,000. Married persons filing separate returns who lived together at any time during the year are not eligible for the Special Allowance. They should enter -0- on lines 8 and 9 and go to line 10.

**Line 6.**—To figure modified adjusted gross income for this line, combine all of the amounts you would enter if you were figuring adjusted gross income for your tax return, except do not include any net gains and losses from passive activities, taxable social security and railroad retirement benefits, and the allowable deduction under section 219 for qualified retirement contributions.

**Example.**—If your adjusted gross income on line 32 of Form 1040 is \$92,000, and you had social security benefits of \$5,500 on line 21b and a deduction for a contribution to a qualified retirement plan of \$3,000 on line 27, your modified adjusted gross income would be \$89,500 (\$92,000 plus \$3,000 minus \$5,500).

Include portfolio income or expenses that are clearly and directly allocable to portfolio income in the modified adjusted gross income computation. Any income that is treated as nonpassive income is included in the computation of modified adjusted gross income. For example, overall income from a publicly traded partnership and net income from an activity or item of property subject to the recharacterization of passive income rules is nonpassive income. In addition, an overall loss from the entire disposition of a passive activity is not included on Form 8582, but the amount of the loss that is treated as a nonpassive loss must be included in the computation of modified adjusted gross income.

**Line 8.**—Do not enter more than \$12,500 on line 8 if you are married filing a separate return and you and your spouse lived apart at all times during the year. Married persons filing separate returns who lived together at any time during the year are not eligible for the Special Allowance. They should enter -0- on lines 8 and 9 and go to line 10.

**Line 10.**—Combine lines 1c and 2c and enter the result. If the result is -0- or net income, skip to line 16 unless you have a pre-enactment loss from significant participation activities that will result in an adjustment to line 12 of Form 8582. If this is the case, complete line 11 and see the instructions for line 12.

**Line 12.**—You may have to adjust the amount you get after subtracting line 11 from line 10 if you had activities that were subject to the recharacterization of passive income rules as explained on page 5.

**Significant participation activities.**—If you completed Worksheet B and the line 12 computation on page 9 of the instructions, you must either increase or decrease (but not below -0-) the amount you get when you subtract line 11 from line 10. If line 10 of Form 8582 and line C on page 9 are losses, add the losses and enter the result on line 12 of Form 8582. If line 10 is a loss and line C is income, reduce the amount you get when you subtract line 11 from line 10 by the income on line C, but not below -0-. If line 10 is income and line C is a loss, the loss on line C is entered on line 12 but only to the extent that it exceeds line 10.

**Example.**—Line 10 is income of \$4,325 and line C is a loss of (\$4,850). Enter \$525 on line 12 and go on to line 13. If line 10 had shown income of \$4,850 and line C had shown a loss of (\$4,325), -0- would be entered on line 12.

**Other activities subject to the recharacterization of passive income rules.**—If you had activities, other than significant participation activities, that were subject to the recharacterization of passive income rules, you will have to adjust line 12 only if the activity is a pre-enactment activity and the activity has prior year unallowed losses.

**Example.**—You have nondepreciable rental property that has current year gross income of \$250,000, current year deductions of \$100,000, and prior year unallowed losses of \$90,000. Because the gross income exceeds current year and prior year losses by \$60,000 (\$250,000 - \$190,000), the \$60,000 is treated as nonpassive income and the remaining \$190,000 is passive income. If line 12 of Form 8582 has a loss from other passive activities, line 12 must be reduced by the \$90,000 of passive income attributable to prior year unallowed losses.

**Line 19.**—Use the worksheets provided in the instructions to figure the unallowed loss to be carried forward and the allowed loss to report on the forms and schedules for 1988. Worksheets 1 and 2, columns (d) and (e), will show whether an activity had an overall gain or loss. If you have activities that show overall gain in column (d) of Parts 1 and/or 2 of Worksheets 1 and/or 2, report all of the income and losses listed in columns (a) and (b) for those activities on the proper forms and schedules.

If you have activities in Worksheet 1 and 2 that show an overall loss in column (e), you will have to allocate the allowed loss on line 19 of Form 8582 to those activities by completing Worksheets 3, 4, and/or 5 and 6.

Start with Worksheet 3 if you have any activities in Worksheet 1 with an overall loss in column (e). If you do not have activities in Worksheet 1 which have an overall loss, start with Worksheet 4 for any activities in Worksheet 2 that show an overall loss in column (e).

### Instructions for Worksheet 3

Use Worksheet 3 if you have a loss on line 1i of Form 8582. If line 1i of Form 8582 shows income, all of the income and losses listed in columns (a), (b), and (c) of Worksheet 1 should be reported on the proper forms and schedules.

**Column (a).**—Enter the overall net loss from column (e) of Worksheet 1 for each activity.

**Column (b).**—Divide each of the individual losses shown in column (a) by the total of all of the losses in column (a) and enter the ratio for each of the activities in column (b). The total of all of the ratios should equal 1.00.

**Column (c).**—Complete the following computation:

**A.** Add the amounts in column (d), Parts 1 and 2 of Worksheet 1. If -0-, enter -0- . . . . .

**B.** Enter the amount from line 9 of Form 8582. If -0-, enter -0- . . . . .

**C.** Add lines A and B . . . . .

Multiply line C by each of the ratios in column (b) and enter the results in column (c). The total of column (c) should be the same as line C above.

**Column (c) total is the same as column (a) total.**—If the total of column (c) is the same as the total of column (a), all of the amounts in columns (a), (b), and (c) of Worksheet 1 should be reported on the proper forms and schedules. Also complete Worksheet 4 if you have activities in Worksheet 2 that have an overall loss in column (e) of that worksheet.

**Column (c) total is less than column (a) total.**—If the total of column (c) is less than the total of column (a), complete column (d) and then go on to Worksheet 4.

**Column (d).**—Subtract column (c) from column (a) and enter the results in this column. Also enter on Worksheet 4 the name of the activities and the form or schedule on which the loss is to be reported. Enter the amounts from column (d) of this worksheet in column (a) of Worksheet 4. Also complete Worksheet 4 if you have activities with an overall loss in column (e) of Worksheet 2.

### Worksheet 3 for Losses on Lines 1b, 1e, and 1h

(Keep for your records.)

Name of activity	Form or schedule to be reported on	(a) Loss (See instructions.)	(b) Ratio (See instructions.)	(c) Income and special allowance (See instructions.)	(d) Subtract column (c) from column (a) (See instructions.)
<b>Totals</b> . . . . . ▶			<b>1.00</b>		

### Instructions for Worksheet 4

Complete Worksheet 4 if you have losses in column (e) of Worksheet 2 and/or losses in column (d) of Worksheet 3.

**Column (a).**—Enter the amounts, if any, from column (d) of Worksheet 3 and the losses, if any, shown in Parts 1 and 2, column (e) of Worksheet 2.

**Column (b).**—Divide each of the individual losses shown in column (a) by the total of all of the losses in column (a) and enter the ratio for each of the activities in column (b). The total of all of the ratios should equal 1.00.

**Column (c).**—Complete the following computation:

**A.** Enter line 3 of Form 8582 . . . . .

**B.** Enter line 17 of Form 8582 . . . . .

**C.** Subtract line B from line A . . . . .

Multiply line C by the ratios in column (b) and enter the results in column (c).

Use Worksheet 5 for the activities listed in Worksheet 4 if all of the loss is reported on one form or schedule. For example, use Worksheet 5 if all of the loss from the activity is reported on Schedule E, even though part of the loss may be a current year loss and part of it may be from a prior year unallowed loss.

If you have losses from the same activity that are to be reported on two or more different schedules, use Worksheet 6 instead of Worksheet 5. For example, if you have a Schedule C loss and you also have a Form 4797 loss from the sale of assets from the Schedule C activity, you should use Worksheet 6 instead of Worksheet 5.

### Worksheet 4 for Allocation of Unallowed Losses

(Keep for your records.)

Name of activity	Forms or schedules to be reported on	(a) Loss (See instructions.)	(b) Ratio (See instructions.)	(c) Unallowed loss (See instructions.)
<b>Totals</b> . . . . . ▶			<b>1.00</b>	

## Instructions for Worksheet 5

**Column (a).**—Enter the activities shown in Worksheet 4 if all of the loss is to be reported on one form or schedule. The loss to enter in column (a) of this worksheet is the current year loss plus the prior year unallowed loss for each activity you enter in this worksheet. This amount can be found by adding columns (b) and (c) in Parts 1 and 2 of Worksheets 1 and 2.

**Column (b).**—Enter the amounts from column (c) of Worksheet 4 for the activities listed in this worksheet. These are your **unallowed losses for 1988**. Keep a record of these amounts so the losses can be used to figure your passive loss next year.

**Column (c).**—Subtract column (b) from column (a). These are the **losses allowed for 1988**. The amounts in this column should be reported on the forms or schedules you usually report the losses on.

## Worksheet 5 for Allowed Losses

(Keep for your records.)

Name of activity	Forms or schedules to be reported on	(a) Loss (See instructions.)	(b) Unallowed loss (See instructions.)	(c) Allowed loss (See instructions.)
<b>Totals</b> . . . . . ▶				

## Instructions for Worksheet 6

Use Worksheet 6 if you have losses that are reported on two or more different forms and schedules. Worksheet 6 will allocate the loss allowed and unallowed for the activity and the loss allowed on the different forms or schedules used to report the losses. Only the losses that would cause a difference in the tax liability if they were reported on a different form or schedules are kept separate. Any losses from the following forms or schedules should be kept separate:

- Schedules C, D (Parts I and II), E, and F.
- Forms 4684 (Section B), 4797 (Parts I and II), and Form 4835.

You should make a copy of Worksheet 6 to use for each additional activity for which you have losses reported on two or more different forms or schedules.

When making entries in Worksheet 6, enter the name of the form or schedule on line 1a and the net loss to be reported on that form or schedule. Line 1b should show any net income that is to be reported on the same form or schedule as the net loss on line 1a.

**Line 1a, column (a).**—The amount to enter on this line is the current year loss plus any prior year loss that goes on the same form, or in the case of Schedule D and Form 4797, the same part (Part I or Part II).

**Line 1b, column (a).**—Enter any current year income that goes on the same form or schedule on which the loss on line 1a, column (a), goes. For example, you entered a prior year loss from Form 4797, Part I, on line 1a and this year you have a current year gain that is also reported on Form 4797, Part I. Enter the gain on line 1b, column (a). If there is no current year income, enter -0-.

**Line 1c, column (b).**—Subtract line 1b, column (a) from line 1a, column (a), and enter the result in column (b). If line 1b, column (a) is more than line 1a, column (a), enter -0- in column (b).

**Column (c).**—Divide each of the losses entered in column (b) by the total of column (b) and enter the ratio in this column. The total of this column should be 1.00.

**Column (d).**—Multiply the unallowed loss for this activity from Worksheet 4, column (c), by the ratio in column (c) of this worksheet. If you have entries in column (b) of this worksheet that show -0-, also enter -0- for that form or schedule in this column.

The amount in this column is the **unallowed loss for 1988**. Keep a record of this worksheet so that you can use the losses to figure your passive activity loss next year.

**Column (e).**—Subtract the amount in column (d) from the loss entered on line 1a, column (a). This is the **allowed loss for 1988** to be entered on the forms or schedules. The forms and schedules you report on should show the losses from this column and any income from line 1b.

# Worksheet 6 for Allowed Losses for Activities With Losses Reported on 2 or More Different Forms or Schedules

	(a) (See instr.)	(b) (See instr.)	(c) Ratio (See instr.)	(d) Unallowed loss (See instr.)	(e) Allowed loss (See instr.)
Name of Activity					
<b>1a</b> Net loss from form or schedule					
<b>b</b> Net income from form or schedule					
<b>c</b> Subtract line 1b from line 1a. If -0- or less, enter -0-					
<b>1a</b> Net loss from form or schedule					
<b>b</b> Net income from form or schedule					
<b>c</b> Subtract line 1b from line 1a. If -0- or less, enter -0-					
<b>1a</b> Net loss from form or schedule					
<b>b</b> Net income from form or schedule					
<b>c</b> Subtract line 1b from line 1a. If -0- or less, enter -0-					
<b>Totals</b>			1.00		

## How To Report Allowed Losses on the Forms and Schedules

Worksheets 5 and 6 (Worksheet 3 if you did not have to complete column (d) of Worksheet 3) show the passive activity losses allowed for 1988. Allowed losses from the worksheets are reported on the forms and schedules you normally use.

**Worksheets 1 and 2.**—If any of the activities in Worksheets 1 or 2 have an overall gain in column (d), all of the losses from those activities are allowed. The losses that are to be reported on the forms or schedules for these activities are the losses shown in columns (b) and (c) of Worksheet 1 or 2. See below for how to enter the losses on specific forms and schedules.

**Worksheet 3.**—If the totals of columns (a) and (c) of Worksheet 3 are the same, all of the losses for the activities listed in that worksheet are allowed. The losses that are reported on the forms and schedules are all of the losses in Parts 1 and 2, columns (b) and (c) of Worksheet 1. Any activities with net profit and any gains from the sale of assets should also be on the forms or schedules. See below for how to enter the losses on specific forms and schedules.

**Worksheet 5.**—Worksheet 5 is only used when you have a loss reported on one form or schedule. Column (c) of Worksheet 5 shows the allowed loss for 1988. Any net profit for the year and any gain from the sale of assets should also be on the forms or schedules your normally report on. See

below for how to enter the losses on specific forms and schedules.

**Worksheet 6.**—Worksheet 6 is used when you have more than one loss reported on different forms or schedules. Column (e) of Worksheet 6 shows the allowed loss for 1988 to be reported on each form or schedule. See below for how to enter the losses on specific forms and schedules.

**Schedules C, F, and Form 4835.**—Enter on the net profit or loss line of your schedule or form, the allowed passive activity loss from the worksheet. To the left of the entry space write, **PAL**.

If the net profit or loss line on your schedule or form showed net profit for the year, reduce the net profit by the allowed loss from the worksheet and enter the result on the net profit or loss line. For example, Schedule C shows net profit for the year of \$5,000 and Form 4797 has a \$2,500 gain. Because there were prior year unallowed losses, the loss allowed for 1988 is (\$6,000). Line 31 of Schedule C would show \$5,000 less the loss allowed of (\$6,000) for a net loss of (\$1,000). To the left of the entry space, write **PAL**.

See Schedule D and Form 4797 instructions below if you also had passive gains and losses from the sale of assets or an interest in the passive activity.

**Schedule E, Part I.**—Enter the allowed loss from the worksheet on line 24 of Schedule E. An activity that has net profit for the year and prior year unallowed losses will have net profit on line 23 and the allowed loss on line 24. The allowed loss on

line 24 will include the loss allowed to the extent of the net profit. Line 25 of Schedule E will show total net profit and line 26 will show total losses allowed (both passive and nonpassive). Line 27 will show the total net profit or loss.

**Schedule E, Parts II and III.**—Any net income shown on your Schedule K-1 that is passive income should be entered as passive income in the appropriate column of Schedule E, Part II or III. Enter the passive loss allowed from the worksheet in the appropriate column for passive losses. The passive losses allowed include the loss allowed to the extent of any net income from the activity. See Schedule D and Form 4797 instructions below if you also had passive gains or losses from the sale of assets or an interest in the passive activity.

**PTPs.**—When you have an overall gain (see **Meaning of Terms** on page 1) held through a PTP, any Schedule E ordinary income or allowed loss should be reported as nonpassive income and loss in columns (i) and (k), in Part II of Schedule E. See the example on page 6 of these instructions under **Passive Activity Loss Rules for Partners in PTPs**.

When you have an overall loss (see **Meaning of Terms** on page 1) from an interest held through a PTP, any Schedule E ordinary income or allowed loss should be reported as passive income and loss in columns (g) and (h) in Part II of Schedule E. See the example on page 6 of these instructions under **Passive Activity Loss Rules for Partners in PTPs**.



**Form 4684, Section B.**—Any passive activity gain from Form 4684 remains unchanged. It was used on Form 8582 to determine allowable passive activity losses. If you did not have passive activity losses on Form 4684, complete Form 4684 and follow the instructions for that form for where to report the gain.

If you had passive activity losses from Form 4684, cross through the amount you first entered on line 13, 14, 20a, 20b, or 21 and show the allowed loss from the worksheet. To the left of the entry space, write **PAL**.

**Schedule D and Form 4797.**—If you sold assets from a passive activity or if you sold an interest in your passive activity, all gains from the activities should be shown on the appropriate line of Schedule D or Form 4797. Identify the gain as **From passive activity**. Any allowed losses for Schedule D or Form 4797 should be entered on the appropriate line and to the left of the entry write **PAL**.

**Entire disposition with an overall loss.**—If you had an entire disposition of your interest in a passive activity and that activity had an overall loss (see **Meaning of Terms** on page 1), none of the gains, if any, or losses should have been entered on Form 8582 or the worksheets. However, all of the gains and losses should be reported on the forms or schedules you normally use. Write to the left of the entry space, **Entire disposition of passive activity**.

**Entire disposition with an overall gain.**—Gains and losses from this activity were included on Form 8582 so that the gains could offset other passive activity losses. Report all of the gains and losses on the forms and schedules you normally use and write to the left of the entry space, **Entire disposition of passive activity**.

### **Election To Treat Investment Interest Expense as Passive Activity Interest**

If you elect to treat investment interest expense from a passive activity that was disallowed investment interest expense in 1986 and carried forward to 1987 as passive activity interest expense, amend your 1987 Form 4952 and Form 8582 by using a 1988 Form 4952 and a 1988 Form 8582 using the modifications given below. The 1988 forms include the tax law changes which were retroactive to 1987.

#### **Changes to make on the 1988 Form 4952 to amend the 1987 Form 4952:**

- a.** Each place the form refers to 1988, replace it with 1987.
- b.** On line 12, replace 60% (.6) with 35% (.35).
- c.** On line 17, enter the smaller of your 1986 disallowed investment interest expense (lines 14, 26, and 35 of your 1986 Form 4952 reduced by the interest expense you elected to treat as passive activity interest expense), or your taxable income from your 1986 Form 1040, line 37 or Form 1041, line 24.
- d.** When completing your 1988 Form 4952, use the amount from line 23 of the refigured 1987 Form 4952 instead of line 14 of the original Form 4952 you filed.

#### **Changes to make on the 1988 Form 8582 to amend the 1987 Form 8582:**

- a.** Use Worksheet 1 or 2 in the 1988 Form 8582 instructions and follow the instructions for the worksheets. Enter the disallowed investment interest expense that you elected to treat as part of the passive activity in the column for prior year unallowed losses.
  - b.** On Form 8582, cross out 1988 each place it appears and write in 1987.
  - c.** On line 15, replace 40% (.4) with 65% (.65).
  - d.** Refigure the losses allowed and unallowed in Worksheets 3, 4, 5, and 6, whichever apply, and follow the instructions for the worksheets.
  - e.** When completing your 1988 Form 8582, your prior year unallowed losses from 1987 are the amounts, if any, in column (b) of Worksheet 5 or column (d) of Worksheet 6 of the refigured Form 8582 worksheets.
- File **Form 1040X**, Amended U.S. Individual Income Tax Return or **Form 1041**, U.S. Fiduciary Income Tax Return, and attach the refigured 1987 Form 4952 and Form 8582.
- If you completed **Form 6251**, Alternative Minimum Tax—Individuals, or **Form 8656**, Alternative Minimum Tax—Fiduciaries, for 1987, you may have to recompute your investment interest expense and passive activity loss for alternative minimum tax purposes using the new rules.